CLARK COUNTY
WASHINGTON

AUDITOR
Greg Kimsey

CABLE TELEVISION
FRANCHISE FEE AUDIT

Report # 01-4

December 3, 2001

Clark County Auditor's Office
Financial Services Internal Audit Department
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CABLE TELEVISION FRANCHISE FEE AUDIT

(For the Year Ending December 31, 2000)

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EXECUTIVE SUMMARY

We have completed an audit of Cable Television Franchise Fees for Clark County, Washington and the City of Vancouver for the year ended December 31, 2000. Our audit of AT&T's Vancouver Franchise Area's financial records, performed in accordance with generally accepted government accounting standards, was intended only to conclude on the stated objectives of this audit. Our review differed from an examination of financial systems and records for the purpose of expressing an opinion thereon, and accordingly we do not express such an opinion.

Audit results are presented in detail in the *Findings and Recommendations* section of this report followed by AT&T's response to our draft report. Our conclusions on the objectives of this audit include recommendations for systems improvements in the allocation of revenues to jurisdictions, and the inclusion of revenues upon which fees are paid.

Objectives, Scope and Methodology

The objectives of this audit work were to determine if franchise fees had been properly calculated and if all appropriate revenues had been included in the fee calculation for the year 2000. In performing this work, we

- evaluated the accuracy of subscriber addresses;
- assessed AT&T's methodology for allocating revenue within the franchise area;
- traced the second quarter revenues from AT&T financial records to source documentation and recomputed the five-percent franchise fee payment;
- reconciled AT&T's reported revenues to its financial records; and
- prepared a schedule of unreported year 2000 revenues for Clark County and the City of Vancouver and calculated fees owed to the two jurisdictions.

Summary of Findings and Recommendations

We found that almost 20 percent of the addresses in AT&T's database were either inaccurate or could not be matched to records maintained in Clark County's GIS system. Revenue allocations within the franchise area were computed correctly, but the methodology used by AT&T was not consistent with that used for the Portland Franchise Area. We are not recommending retroactive adjustments, but **we do recommend** that AT&T make address code corrections on active billing addresses to achieve a match rate of 99 percent with Clark County's GIS system before the end of the year and that AT&T apply the same allocation methodology to all areas. **We also recommend** that the City/County Cable Office perform an annual record match on AT&T's active records and that the City/County Cable Office monitor and validate the monthly allocation ratios based on AT&T's Franchise Fee Schedules submitted with fee payments.

Finally, we found under and unreported revenues derived from advertising and the production of advertising; commissions from the Home Shopping Network; bad debt expenses; FCC fees; tower rental; and other miscellaneous revenue resulting from accounting inaccuracies. **We recommend** that AT&T pay franchise fees that would be owed to Clark County and Vancouver on these revenues. To ensure future revenues are proper, **we recommend** that the City/County Cable Office compare revenue allocations reported on the quarterly Franchise Fee Schedule with AT&T support documentation from its accounting system. Performing these analytical reviews would help to ensure that all appropriate revenues have been included in the calculation of the franchise fee payment.

Our calculations of fees owed by AT&T for calendar year 2000 on under reported and unreported revenues, along with interest, by jurisdiction, is shown below. A separate billing letter will be sent to AT&T requesting payment for these amounts.

	Vancouver	Clark County
Advertising Revenues	$14,488	$12,843
Other Revenues	4,385	3,353
Totals	$18,873	$16,196
Interest @ 12% on Underpayment	2,265	1,944
Total Payment	$21,138	$18,140

We would like to thank the staffs of AT&T Broadband, Clark County Assessor's Office, and the City/County Cable Office for their cooperation and assistance with this audit.

INTRODUCTION

The City of Vancouver and Clark County entered into an inter-local agreement in June 1980, calling for proposals to construct and operate a joint cable television system within Clark County. Clark County and the City of Vancouver jointly share responsibility for cable television administration through the City/County Cable Office. In October 1981, in accordance with this agreement, Cox-Columbia was granted a 15-year non-exclusive cable franchise authorizing the company to construct and maintain a cable system within the County. In 1986, Cox sold its interest to Columbia Cable of Washington, with Columbia assuming franchise rights and obligations. TCI of Southern Washington (TCI) purchased Columbia in December 1995. A new 10-year franchise agreement was negotiated with TCI in November 1997. TCI was acquired by AT&T Broadband (AT&T) and since March 1999 has been doing business as AT&T Cable Services.

AT&T and the jurisdictions within the Vancouver Franchise Area (referred to hereinafter as the Southern Washington Franchise Area) have a franchise agreement requiring AT&T to remit five percent of gross revenues from all sources attributable from cable operations. The jurisdictions are Clark County (for the unincorporated areas of the county) and the cities of Vancouver, Ridgefield, LaCenter, Battle Ground, Camas, and Washougal, Washington, as well as Hayden Island, Oregon. For the year ended December 31, 2000, AT&T reported gross revenues and franchise fees to the Southern Washington Franchise Area of approximately $35.8 million and $1.7 million respectively. Of that, the City of Vancouver received franchise fees of $832,529 and Clark County of $742,765.

AT&T also collected monthly Public, Educational, and Governmental (PEG) fees of $1 from subscribers in Vancouver and unincorporated Clark County to support capital needs for access to current programmed PEG channels and to upgrade the capacity to enhance local cable video programming. For 2000, PEG fee revenue was $336,323 and $309,498 for the City of Vancouver and Clark County respectively.

Customers are counted as Equivalent Basic Units (EBU) in the cable services industry to adjust for commercial and bulk revenues above or below the standard cable revenue rate. By dividing the actual revenues for bulk and commercial accounts by the standard cable rate, the EBU count is either greater than or less than a full subscriber. There were 71,868 EBUs in the Southern Washington Franchise Area as of December 31, 1999 and 72,308 EBUs as of December 31, 2000.

FINDINGS AND RECOMMENDATIONS

1. FRANCHISE AREA BOUNDARY ACCURACY

AT&T uses the "agent codes" established by the FCC in its billing system to differentiate between the jurisdictions within a specific franchise area. AT&T assigns an agent code to each customer's address to monitor the specific services purchased each month and to report the revenues applicable to each jurisdiction within the cable franchise area. There are ten agent codes and eight jurisdictions within the Southern Washington Franchise Area. Clark County and Vancouver each have two agent codes.

Finding:

Total franchise fees paid by AT&T to the jurisdictions in 2000 were not distributed correctly because of agent code discrepancies in AT&T's CSG billing system. AT&T is aware of its database limitations and has started using Map Marker Plus, which uses a 15-digit geocode on a customer address for more location precision. AT&T expects to have the data fully integrated with geocodes and have their operating procedures updated within 18 months. This is a significant improvement over its reliance on zip codes, but it will not ensure that addresses map correctly to the site location.

We tested the franchise boundaries to assess the agent code accuracy of AT&T's database at a point in time. On June 18, 2001 there were 65,226 active records (48.3 percent) and 69,853 inactive records (51.7 percent) in a database of 134,981 records. Our examination of agent code accuracy, performed on the active records only, produced the following results:

- ✓ 81.0 percent (52,855) had accurate agent numbers.
- ✓ 13.7 percent (8,939) of the addresses could not be matched to the records maintained in the Clark County Assessor's Office GIS system. The primary reason for the unmatched addresses is the absence of directional indicators (i.e., SE, NE) in AT&T's database for streets that span more than one agent code.
- ✓ 5.3 percent (3,432) were inaccurate, mostly between Vancouver and Clark County. There were 2,413 records in Vancouver that should have had a Clark County agent number and 936 in Clark County that should have had a Vancouver agent number. If the 5.3 percent error rate were applied to the 8,939 unmatched records, then 474 more records would also have an incorrect address code.

We excluded the 69,753 inactive records from testing due to the low number of matches with the County's GIS system. This would have resulted in a higher discrepancy rate and, given the volume of changes occurring each month, would not have been representative of the population. Nevertheless, we are concerned about these inactive addresses because they are readily convertible to an active status.

Recommendation

It is important to note that it would not be cost-effective to make agent code corrections to historical data to redistribute revenues between the jurisdictions. Our focus was to ensure that future franchise fees are distributed properly by assisting AT&T's Data Integrity Group in their effort to enhance the integrity of its database. To that end, **we recommend** the following:

- ✓ Clark County's GIS Manager gives the agent code corrections identified during testing to AT&T's Systems Design Manager to update its database.
- ✓ AT&T makes the necessary corrections to the active records in its CSG billing system to achieve a match rate of 99 percent (by parcel or road) with the addressing databases in Clark County's GIS system.
- ✓ AT&T's Systems Design Manager submit an electronic file of active records to Clark County's GIS Manager before December 31, 2001, and annually thereafter, to verify that the 99 percent match rate has been maintained.
- ✓ The Director of the City/County Cable Office ensures that the record match is performed on AT&T's active records annually.

Response

AT&T Broadband will share its process for addressing geo-coding with the Clark County GIS manager, and periodically monitor accuracy to insure integrity within the system. They agree with the 99 percent accuracy goal and hope to have new procedures in place by December 2001 and corrections to existing addresses made by April 2002.

The Director of the City/County Cable Office will ensure that the record match is performed on AT&T's active records on an annual basis.

2. INCONSISTENT ALLOCATION METHODOLOGIES

Revenues from other cable operations are allocated to the jurisdictions based on the subscriber EBU counts within each agent code, excluding commercial and bulk accounts. AT&T established the subscriber EBU counts for the Southern Washington Franchise Area for 2000 and the resulting allocation ratios at the end of 1999 as follows:

Agent No	*Entity*	*EBUs*	*Allocation*
10 & 90	Vancouver	29,918	46.69%
20 & 100	Clark County	26,520	41.39%
30	Washougal	1,595	2.49%
40	Camas	3,213	5.01%
50	Hayden Island	709	1.10%
60	La Center	320	0.50%
70	Battle Ground	1,417	2.21%
80	Ridgefield	392	0.62%
		64,084	100.01%

Finding

The revenue allocations we examined within the Southern Washington Franchise Area were computed correctly based on the fixed subscriber EBU count above, but the methodology was not consistent with the one used for the Portland Franchise Area. Franchise fee payments to the jurisdictions did not reflect the changes in subscriber EBU counts that occurred during the year.

The Southern Washington Franchise Area is a subset of the Portland Franchise Area, but AT&T uses different methodologies to allocate revenues to the entities within the franchise areas. First, revenues are allocated to the entities in the Portland Franchise Area based on *monthly* subscriber EBU counts. In 2000, the revenues allocated monthly from the Portland Franchise Area to the Southern Washington Franchise Area ranged from 15.02 percent to 15.34 percent. Next, the portion allocated to the Southern Washington Franchise Area is allocated again to the jurisdictions above based on the *annual* subscriber EBU counts established at the end of the prior year.

The revenue allocated within the Southern Washington Franchise Area will remain constant using either methodology, but the allocation ratios would change with monthly subscriber EBU counts. A stronger correlation between revenue allocations and monthly changes in subscriber EBU counts would make franchise fee payments to the jurisdictions within the Southern Washington Franchise Area more accurate.

Recommendation

On a going-forward basis, **we recommend** the following:

- ✓ AT&T applies the same allocation methodology to the jurisdictions within the Southern Washington Franchise Area as it does with the Portland Franchise Area.

- ✓ AT&T documents the subscriber EBU count used to allocate revenues within the Southern Washington Franchise Area on the *Franchise Fee Schedule* submitted with quarterly franchise fee payments.

- ✓ The Director of the City/County Cable Office validates the monthly allocation ratios.

<u>Response</u>

AT&T Broadband has agreed to review their allocation methodologies in order to insure consistency. They agreed to a quarterly methodology, rather than monthly.

The Director of the City/County Cable Office has agreed to validate the allocation ratios and this office will provide guidance as needed to assist them in their efforts.

3. ADDITIONAL REVENUES SUBJECT TO FRANCHISE FEES

The unreported and under reported revenues identified during the audit are categorized in this section as Advertising Revenues and Other Revenues. A discussion on these revenues is presented below along with the franchise fees owed to Vancouver and Clark County. See *Appendix A* for a summary of the additional revenues and franchise fees.

ADVERTISING REVENUES

3.1 Commissions Netted With Advertising Revenue

<u>Finding</u>

Local and national advertising agencies and national sales representative firms keep a portion of the gross revenues received from advertisers as commission for services rendered and remit the remainder to AT&T. TCI Media Service (TMS), a division of AT&T, allocates advertising revenues to the Portland Franchise Area net of local and national commissions. This accounting practice is not in accordance with Generally Accepted Accounting Principles (GAAP). Gross revenues from advertising should not be reduced by commission expense. Revenues and expenses, as basic elements in the conceptual framework of financial accounting, should be determined independently. Commissions paid to employees or others in place of compensation for salaries or services rendered should not be charged to a revenue account.

AT&T's accounting practice is based on *Staff Accounting Bulletin (SAB) No. 101*, which provides guidance on the recognition, presentation, and disclosure of revenue in financial statements filed with the U.S Securities and Exchange Commission (SEC). SAB No.101 was the SEC's response to a March 1999 report on fraudulent financial reporting, which cited cases involving improper revenue recognition. SAB 101 does not change any of the existing rules on revenue recognition. In fact, SAB 101 supports our position that the full amount paid by the advertiser should be recognized as revenue. The way the cash flows between the advertising companies and AT&T is irrelevant in the recognition of revenue. In fact, AT&T is paying for services rendered from the gross revenues received from the advertiser and the advertising companies are recognizing these commissions as revenue.

As a result of this accounting practice, advertising revenues allocated to the Portland Franchise Area were understated by $3,573,731. Approximately 15 percent ($543,722) of those revenues should have been allocated to the Southern Washington Franchise Area. The following pro-rata franchise fees should have been paid to Clark County and Vancouver:

Entity	*Allocation %*	*Revenue*	*Franchise Fee*
Vancouver – Agent 10 & 90	46.69%	$253,864	$12,693
Clark County – Agent 20 & 100	41.39%	225,046	11,252
All Other Jurisdictions	11.92%	64,812	3,241
	100.00%	$543,722	$27,186

Response

AT&T Broadband disputes the audit finding regarding commissions netted with advertising revenues. Their full response is in *Appendix C*. We continue to assert that the way the cash flows between the advertising companies and AT&T is irrelevant in the recognition of revenue for computation of the franchise fee and that the full amount of revenue paid by the advertiser should be recognized in the computation of gross revenues. Netting a portion of the amounts charged to advertisers reduces the revenue by the expense of obtaining it. This approach is inconsistent with Generally Accepted Accounting Principles. Under GAAP revenue should not be net of expenses incurred to generate the revenue.

3.2 Production Revenue

Finding

TMS allocated $56,115 in revenues from the production of advertising to the Southern Washington Franchise Area, but AT&T did not report it. The following pro-rata franchise fees should have been paid to Clark County and Vancouver:

Entity	*Allocation %*	*Revenue*	*Franchise Fee*
Vancouver - Agent 10 & 90	46.69%	$26,197	$1,310
Clark County - Agent 20 & 100	41.39%	23,224	1,161
All Other Jurisdictions	11.92%	6,694	335
	100.00%	$56,115	$2,806

Response

The Company disputes the finding and takes the position that production revenue should not be included in the calculation of franchise fees.

3.3 Marketing Cost Reimbursements

Fees received from programmers to promote existing programs or to launch new ones are not recorded as revenue. The fees are booked as a direct reduction to the marketing expenses incurred to provide marketing services to programmers. AT&T's accounting policy is that launch fees and co-op reimbursements generally should be recognized as a contra-programming expense on a straight line basis over the life of the programming contract.

This accounting practice understates both revenues and expenses and it is not in accordance with GAAP. Transactions between separate corporate entities must be at a price that is compensatory or the basis of that transaction is not at "arm's length". Accordingly, the compensation for services rendered should be classified as advertising revenue.

Marketing reimbursements in the amount of $136,390 were not allocated to the Portland Franchise Area. Approximately 15 percent ($20,797) of that revenue should have been allocated to the Southern Washington Franchise Area. The following pro-rata franchise fees should have been paid to Clark County and Vancouver:

Entity	*Allocation %*	*Revenue*	*Franchise Fee*
Vancouver – Agent 10 & 90	46.69%	$9,709	$485
Clark County - Agent 20 & 100	41.39%	8,607	430
All Other Jurisdictions	11.92%	2,481	124
	100.00%	$20,797	$1,039

Response

AT&T disputes the finding that reimbursement of marketing costs should be included as revenue and included in the franchise fee revenue calculations. This practice of netting revenues against expenditures, however, is not consistent with GAAP, and results in an understatement of gross revenue.

3.4 Prior Year Advertising Revenue

Finding

Advertising revenue of $10,650 from the prior year was recognized in May on the *Adjustment Summary*, but it was not reported. As a result, the advertising revenue allocated to the Portland Franchise Area was understated by that amount. AT&T reports that the Southern Washington Franchise Area allocation percentage was 15.24 percent for that period. Therefore, advertising revenues reported to the Southern Washington Franchise Area were understated by $1,623. The following pro-rata franchise fees should have been paid to Clark County and Vancouver:

Entity	*Allocation %*	*Revenue*	*Franchise Fee*
Vancouver – Agent 10 & 90	46.69%	758	38
Clark County - Agent 20 & 100	41.39%	672	34
All Other Jurisdictions	11.92%	193	9
	100.00%	$1,623	$82

Response

AT&T explained this prior year adjustment as a liability that reflects additional expense related to advertising commissions. Based on this additional information, these amounts would not be owing and will be removed from the overall schedule found in *Appendix A*.

OTHER REVENUES

3.5 **Uncollected Commission Revenue**

Finding

AT&T receives commission revenue from Quality Value Convenience (QVC) and Home Shopping Network (HSN) on the sale of merchandise offered over the cable. TCI received a lump sum payment from HSN when they negotiated the terms of the agreement in 1995 and it amortized the revenue over the life of the contract. AT&T acquired TCI in 1999 and continued the same accounting practice for recognizing revenue.

AT&T reports that it has not received all the commissions it is entitled to from HSN for merchandise sales from prior years. AT&T and HSN will determine the amount of the uncollected commission revenue, which is subject to franchise fees. In 2000, the allocation to the Southern Washington Franchise Area for commissions from QVC was approximately $85,400. It is reasonable to use that amount to estimate the uncollected commission revenue for 2000 from HSN.

Recommendation

We recommend that AT&T gives Clark County and Vancouver a schedule of the uncollected HSN commission revenues from prior years and remit franchise fees to Clark County and Vancouver on that amount.

The following is an estimate of the pro-rata franchise fees on the uncollected HSN commission revenue for 2000 for Clark County and Vancouver:

Entity	*Allocation %*	*Revenue*	*Franchise Fee*
Vancouver – Agent 10 & 90	46.69%	$39,873	$1,994
Clark County - Agent 20 & 100	41.39%	35,347	1,767
All Other Jurisdictions	11.92%	10,180	2,509
	100.00%	$85,400	$4,270

Response

AT&T states that they are currently in the process of working with HSN to determine the nature, magnitude, and amount associated with potential commissions earned. AT&T will provide franchise fees on these revenues when they are received.

3.6 **Bad Debt Recovery Reversals**

The CSG billing system summarizes revenue and other customer-related cable service transactions monthly on the *Financial Summary Report* (CPSM318). Within the CSG billing system, a sub-routine ages the accounts receivable and determines the monthly write-off of uncollectible accounts. A schedule on the *Financial Summary Report* identifies the gross monthly write-off balance and computes the net write-off for the month by deducting payments, miscellaneous credits, service adjustments, and statement charges. Miscellaneous credits, service adjustments, and statement charges are mapped to the allowance for doubtful accounts and automatically reversed from that account.

Finding

Miscellaneous credits, service adjustments, and statement charges are manually reversed before the bad debt write-off is reported on the *Franchise Fee Schedule* submitted with quarterly franchise fees. This reversal effectively reduces franchise fees. AT&T's reasoning for the reversal of service adjustments (the largest of the three components) is that they represent the forgiven portion of previously written off invoices.

When the customer pays a bill that has been previously written off to bad debt, both the payment and the service adjustment are recorded in bad debt recovery. The service adjustment is the portion of the recovered bad debt kept by the collection agency as payment for services rendered. Even though AT&T did not receive the entire amount collected from the customer, the full amount is recovered bad debt expense and should not be reduced by collection expense. The bad debt write-off against revenues from cable services is increased by the service adjustment reversal.

Unreported bad debt recovery from improperly reversed service adjustments is estimated at $67,320 for the Southern Washington Franchise Area. This is based on 2nd quarter results of $16,830 and projected service credits for remaining quarters of $50,490. The following pro-rata franchise fees should have been paid to Clark County and Vancouver:

Entity	*Allocation %*	*Revenue*	*Franchise Fee*
Vancouver – Agent 10 & 90	46.69%	$31,432	$1,572
Clark County - Agent 20 & 100	41.39%	27,864	1,393
All Other Jurisdictions	11.92%	8,024	401
	100.00%	$67,320	$3,366

Response

AT&T Broadband does not contest our recommendation related to the Bad Debt Recovery Reversal, as stated above. However, AT&T has recently changed its procedures regarding recording of bad debt and they have determined actual amounts due to both Clark County and Vancouver as follows:

Entity	*Revenue*	*Franchise Fee*
Vancouver – Agent 10 & 90	$23,665	$1,183
Clark County - Agent 20 & 100	10,313	516
	$33,978	$1,699

3.7 **FCC Surcharge**

Finding

AT&T must pay a fee to the FCC to operate a cable business, but the FCC does not require AT&T to collect it from cable customers. As a result, the fees AT&T pays to the FCC are a business expense and the fees they collect from customers are considered revenues. FCC surcharges of $29,063 were allocated from the Portland Franchise Area to the Southern Washington Franchise Area, but AT&T did not report them. The following pro-rata franchise fees on these revenues should have been paid to Clark County and Vancouver:

Entity	*Allocation %*	*Revenue*	*Franchise Fee*
Vancouver – Agent 10 & 90	46.69%	$13,570	$679
Clark County - Agent 20 & 100	41.39%	12,029	601
All Other Jurisdictions	11.92%	3,464	173
	100.00%	$29,063	$1,453

Response

AT&T agrees with our recommendation and concurs with the calculated fee amount of $1,453.

3.8 **Tower Rental Income**

AT&T received tower rental income in the amount of $28,800 during July, August and September, but it was not reported. The following pro-rata franchise fees on these revenues should have been paid to Clark County and Vancouver:

Entity	*Allocation %*	*Revenue*	*Franchise Fee*
Vancouver – Agent 10 & 90	46.69%	$13,447	$672
Clark County - Agent 20 & 100	41.39%	11,920	596
All Other Jurisdictions	11.92%	3,433	172
	100.00%	$28,800	$1,440

Response

AT&T agrees with the audit finding that tower rental should be included in the franchise fee calculation. However, during their review of the rental payments, they found that one of the payments meant for another system was inadvertently appropriated to the Vancouver system. AT&T will provide Clark County detail information related to the lease agreements supporting the miss-appropriated payments.

The adjusted revenues associated with tower rental income were re-calculated to $18,600, as follows:

Entity	*Allocation %*	*Revenue*	*Franchise Fee*
Vancouver – Agent 10 & 90	46.69%	$8,684	$434
Clark County - Agent 20 & 100	41.39%	7,699	385
All Other Jurisdictions	11.92%	2,217	111
	100.00%	$18,600	$930

3.9 **Miscellaneous Income**

Finding

Other income is compiled monthly on the *Miscellaneous Income Summary* and reported separately on the *Franchise Fee Schedule* submitted with quarterly franchise fee payments. AT&T did not report miscellaneous income of $4,082 due to accounting errors. The following pro-rata franchise fees on these revenues should have been paid to Clark County and Vancouver:

Entity	*Allocation %*	*Revenue*	*Franchise Fee*
Vancouver – Agent 10 & 90	46.69%	$1,906	$95
Clark County - Agent 20 & 100	41.39%	1,690	84
All Other Jurisdictions	11.92%	487	25
	100.00%	$4,082	$204

Recommendation

We recommend that the Director of the City/County Cable Office perform certain analytical review procedures quarterly to ensure that all revenues subject to franchise fees are reported to Vancouver and Clark County. At least, the Director (or delegate) should:

- ✓ Compare the revenue allocations reported on the *Franchise Fee Schedule* submitted quarterly with franchise fee payments to AT&T's support documentation for the allocations from its general ledger.

- ✓ Validate specific revenues reported on the *Franchise Fee Schedule* with the *Financial Summary Report* (CPSM318) generated monthly by the CSG billing system.

Response

AT&T has recently changed its procedures to include the miscellaneous income, as identified in this audit. For the full year 2001, this revenue item will be included in their reporting.

The Director of the City/County Cable Office has agreed to perform the recommended analytical review procedures.

SCHEDULE OF REVENUES SUBJECT TO FRANCHISE FEES

		Vancouver		***Clark County***	
Description	Total Revenues[1]	Revenue	Franchise Fee	Revenue	Franchise Fee
ADVERTISING REVENUES					
Ad Sales Revenues	$543,722	$253,864	$12,693	$225,046	$11,252
Production Revenues	56,115	26,197	1,310	23,224	1,161
Marketing Reimbursements	20,797	9,709	485	8,607	430
OTHER REVENUES					
Estimated HSN Commission Revenue	85,400	39,873	1,994	35,347	1,767
Bad Debt Recovery	Not provided	23,665	1,183	10,313	516
FCC Surcharge	29,063	13,570	679	12,029	601
Tower Rental Income	18,600	8,684	434	7,699	385
Miscellaneous Income	4,082	1,906	95	1,690	84
Totals	$757,779	$363,898	$18,873	$323,955	$16,196

[1] *The revenues that should have been allocated to all the jurisdictions within the Southern Washington Franchise Area.*

OBJECTIVES, SCOPE AND METHODOLOGY

The objectives of this audit were to determine whether:

- ✓ Franchise fee payments to the jurisdictions within the Southern Washington Franchise Area were based on properly recognized City/County addresses; and
- ✓ Franchise fees for Clark County and the City of Vancouver were calculated properly and all appropriate revenues were included in the fee calculation.

To meet these objectives, we

- ✓ Coordinated the audit with City/County Cable Television Office and City of Vancouver.
- ✓ Reviewed relevant documents, contracts, related county codes, ordinances, resolutions, and Federal Communications Commission (FCC) rulings.
- ✓ Evaluated the accuracy of address codes by matching a sample of Southern Washington Franchise Area subscriber addresses from AT&T's billing system, Cable Systems Group (CSG), to ArcView, the geographic information system (GIS) maintained by Clark County Assessor's Office.
- ✓ Selected the 2^{nd} quarter franchise fee as the audit sample based on a variance analysis of the gross revenues reported to Clark County with franchise fee payments to the *Gross Receipts Exam* performed by PricewaterhouseCoopers in accordance with the franchise agreement.
- ✓ Traced 2^{nd} quarter revenues to source documentation, *except for* the general ledger transaction detail for write-off reversals and Home Shopping Network revenue, and discussed the differences with AT&T management to recompute the 5 percent franchise fee payment.
- ✓ Matched subscriber EBU counts for the Southern Washington Franchise Area to AT&T's billing system. We did not perform this test on subscriber EBU counts for the Portland Franchise Area.
- ✓ Reconciled the reported revenues for the year to AT&T financial records and audited financial statement of gross receipts.
- ✓ Prepared a schedule of unreported revenues for 2000 for Clark County and the City of Vancouver.
- ✓ Identified changes the County, City, and AT&T can make to process franchise fees more efficiently and effectively.

September 21, 2001 VIA E-MAIL & AIRBORNE EXPRESS

Linda S. Bade, Operations Review Manager
Clark County Washington
1200 Franklin Street
Vancouver, WA 98666

Dear Linda,

TCI Cablevision of Southern Washington, Inc. (providing service as "AT&T Broadband") has had an opportunity to review the issues raised in your audit report of August 31, 2001. Based on that review we have prepared the attached response.

The Company has taken significant measures this year to improve the accuracy of collecting, calculating, and paying franchise fees to the City and County. At the time the audit was conducted, a number of reporting issues identified during the audit process had already been addressed, or were in the process of being addressed by the Company.

As always, continued review of systems and processes benefit the Company, the City and the County. If you have additional questions or concerns regarding response to your audit findings, please feel free to call Brad Kaplan 503-963-5140, Debbie Luppold 425-398-6140, or me 503-963-5173.

Sincerely,

David B. Yordy
Finance Manager
AT&T Broadband – Oregon Market

cc. Donna Mason, Director, City/County Cable TV Office
Linda Eki, Internal Performance Auditor, Clark County
Brad Kaplan VP Finance, Debbie Luppold VP Franchising & Government Affairs, Jeanne Benecke Director Franchising, Tony Thompson Financial Analyst, AT&T

Clark County / City of Vancouver Audit
Audit Response AT&T BROADBAND – September 21, 2001

FINDINGS - UNCONTESTED:

AT&T BROADBAND has recently changed its procedures to include the following areas as identified in the audit. For the full year of 2001, revenue items related to those areas below have been, or subsequently will be, included in our reporting.

Audit Finding	Fee amount
3.7 FCC SURCHARGE	$1,453.00
3.6 BAD DEBT RECOVERY REVERSAL	1,699.00
3.9 MISC INCOME	204.00

Reductions in the bad debt recovery amounts for all agents in both Clark County and Vancouver were recalculated based on the CPSM 318 report rather than estimates as indicated in the audit findings. The balance is revised and reflected above in 3.6 BAD DEBT RECOVERY REVERSAL.

Entity	Revenue	Franchise Fee
Vancouver – Agent 10 & 90	$23,665	$1,183
Clark County – Agent 20 & 100	10,313	516
	$33,978	$1,699

FINDINGS – AT&T BROADBAND RESPONSE:

1. FRANCHISE BOUNDARY ACCURACY:

Recognizing that database integrity is of significant importance to both franchise reporting and our engineering process, the recent development of the AT&T BROADBAND Data Integrity Group will provide more resources to this effort. Assuming extrapolation of the Clark County audit finding, current franchise agent accuracy would be 94%.

As indicated previously, AT&T BROADBAND will have operating procedures established allowing for specific geo-coding of addresses with implementation over the next four months. Our expectation is that this process and methodology will improve franchise agent accuracy over its period of implementation.

Response:

- AT&T BROADBAND will share its process for addressing geo-coding with the Clark County GIS manager. Assuming the process accurately matches addresses to agent, AT&T BROADBAND will periodically monitor accuracy to insure integrity within the system.

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Many of the issues related to unmatched agents were attributable to directional coding issues within the data. Since the County matching methodology included the matching of addresses based on complete address listing, including directional information, correction needs to occur to the CSG records.

AT&T BROADBAND agrees with a goal of achieving 99% agent accuracy, and reviews annually. Given timing and implementation of new procedures, AT&T will have new procedures in place by December 2001 with corrections reflecting the agent accuracy goal by April, 2002.

2. ALLOCATION METHODOLGIES:

Allocation methodologies used by AT&T BROADBAND have been accepted historically as a representative basis to determine agent level franchise revenue. It is recognized that there are different allocation methodologies used for corporate advertising to the Portland Market vs. subsequent allocation within agents for a particular System. It is not clear that monthly allocations would provide a significant and material benefit in terms of allocation of revenues.

Response:

- AT&T BROADBAND agrees to review current allocation methodologies and insure consistency between the allocation methodology used for corporate advertising and subsequent allocation to agents. The final allocation methodology will be quarterly.

3.1 COMMISSIONS NETTED WITH ADVERTISING REVENUE

AT&T BROADBAND recognizes advertising revenue, net of advertising commission agreements, based on the SAB no. 101. To-date there have been no external audit findings stating that AT&T BROADBAND's revenue recognition practices misrepresent or misstate the underlying economics of the business and are in compliance with GAAP.

Response:

- AT&T BROADBAND disputes the audit findings regarding this issue and will continue to report advertising revenue net commissions in compliance with directions received from the Company's outside auditors.

3.2 PRODUCTION REVENUE:

AT&T BROADBAND agrees with the amount of production revenue as defined in the audit finding as correct. However, based on the gross revenues definition in both the Vancouver and Clark County franchise agreements, the Company takes the position that production revenue should not be included in the calculation of gross revenues for payment of franchise fees as it is not derived "…from the operations of the Cable System to provide Cable Service within the franchise area."

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Response:

- The Company disputes the finding and takes the position that production revenue should not be included in the calculation of franchise fees.

3.3 MARKETING COST REIMBURSEMENTS:

AT&T BROADBAND is reimbursed from programmers for certain expenses. Through these arrangements, AT&T BROADBAND receives “direct” or “indirect” reimbursement of certain costs associated with its promotion of certain programmers’ products. Additionally, there has been no external audit opinion drafted related to GAAP non-compliance issues.

Response:

- The Company disputes the finding that reimbursement of marketing costs should be included as revenue and included in the franchise fee revenue calculations.

3.4 PRIOR YEAR ADVERTISING REVENUE:

The prior year adjustment to a liability reflects additional expense related to advertising commissions. The assumption is that this would increase commission expense resulting in an add-back, assuming reporting advertising revenues including commissions.

Response:

- AT&T BROADBAND will continue to report advertising revenue net commissions in compliance with directions received from the Company’s outside auditors

3.5 UNCOLLECTED COMMISSION REVENUE:

AT&T BROADBAND is currently in the process of working with HSN to determine the nature, magnitude, and amount associated with potential commissions earned. This involves verification of historic subscriber balances, and settlement on final reimbursement.

Response:

- Given the relative uncertainty of the amount to be obtained by HSN, and the fact that revenues have not been recognized to-date, revenues associated with settlement will be reflected on the franchise fee payment when received by AT&T BROADBAND.

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3.8 TOWER RENTAL INCOME:

AT&T agrees with the finding that revenue from tower rental should be included in the franchise fee calculations. However, on further review of the rental payments, it became clear that one of the payments intended for another system was inadvertently appropriated to the Vancouver system. AT&T will provide Clark County detail information related to lease agreements supporting the miss-appropriated payments.

Response:

AT&T agrees to the following payment associated with tower rentals. The adjusted revenues associated with Tower Rental income were $18,600.

Entity	Allocation %	Revenue	Franchise Fee
Vancouver – Agent 10 & 90	46.69%	$ 8,684	$434
Clark County – Agent 20 & 100	41.39%	7,699	385
All Other Jurisdictions	11.92%	2,217	111
		$18,600	$930

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